



FedFin Client Report

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FinServ GOP Kicks Off GSE Reform Hearings with QM Complaints

Client Report: **GSE138**

Executive Summary

In this report, we assess the first of a series of House FinServ hearings on housing finance reform, with Republicans today targeting the GSEs' exemption from the QM rule, rather than broader questions about what to do with the conservatorship. Chairman Hensarling (R-TX) and Rep. Duffy (R-WI) argued that the QM's debt to income requirements should apply to the GSEs or be removed to ensure a level playing field. FHFA Director Watt defended current practice and said that the CFPB is in the process of reevaluating the rule as required by statute. Turning to broader issues, Ranking Member Waters (D-CA) warned that any attempt by Chair Hensarling to push the PATH Act would once again face fierce Democratic opposition, arguing that housing reform should include an explicit, paid-for government backstop, promote affordability, protect the 30-year FRM, preserve the housing trust fund, support the multifamily housing market, and ensure equal market access. This report analyzes today's session, which also focused on whether FHFA in the absence of reform should allow the GSEs to build a capital buffer. Director Watt argued strongly for the need for such a buffer but demurred on his ability or willingness to create one without Treasury agreement.

Analysis

Opening Statements

Chairman Hensarling said it is time to enact housing reform and praised FHFA for developing the credit-risk transfer programs and the common securitization platform. However, he said he is concerned about efforts to lower down-payment requirements, raise the debt-to-income ratio, and divert funds to a housing trust fund that he says lacks accountability.

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Ranking Member Waters praised FHFA for protecting taxpayers through credit risk shares and three percent downpayments. She criticized the PATH Act and the lack of hearings on housing reform.

Rep. Duffy praised credit risk transfer programs and the CSP, stressing that private capital should play a larger role in the housing market.

Rep. Cleaver (D-MO) seemed to suggest that he is willing to turn the issue of housing reform over to FHFA for at least the next year and a half, although he did say he hoped that there would be a legislative solution.

Rep. Kildee (D-MI) expressed concern over the bulk sale of foreclosed homes to large private investors such as Blackstone and argued that they can stunt community revitalization.

Testimony

FHFA Director Watt argued that the current conservatorship is unsustainable and that it is Congress' responsibility to broadly reform the housing system and determine the fate of the GSEs. During the conservatorships, FHFA has ensured that Fannie Mae and Freddie Mac have transferred a significant amount of risk to the private sector and noted that significant work has been done on CSP, duty to serve obligations, and common securitization.

Q&A

- **Qualified Mortgage Rule:** Reps. Hensarling, Duffy, Barr (R-KY), Rothfus (R-PA), and Trott (R-MI) argued that the GSEs' ability to hold loans with higher debt-to-income ratios disadvantages the private sector. Mr. Watt said the GSEs' non-QM process will allow the CFPB to properly assess the effects the rule and that this may result in a consolidated one. Mr. Watt also pushed back on concerns that the QM is affecting community banks saying that these organizations are largely exempt. Rep. Hensarling also argued that lower required downpayments are putting people in homes they cannot afford. Mr. Watt said the default rates for these borrowers are similar to the rates for other borrowers.
- **Credit Risk Transfers:** Rep. Royce (R-CA) and Luetkemeyer (R-MO) pressed Mr. Watt to do more to encourage front-end risk transfers. Mr. Watt said that the agency is doing as much as it can given that requiring a specific number may not be cost effective. On the back-end, Rep. Royce asked about CAS and STACR

offerings and if they will qualify for REIT investors. Mr. Watt said FHFA and the GSEs are trying to make this work but may require statutory changes.

- **Capital Buffer:** Reps. Beatty (D-OH) successfully pressed Mr. Watt to again assert his authority to unilaterally prevent the depletion of the GSEs' capital buffers, although Mr. Watt did stress that his preference is to come to an agreement with Treasury. Reps. Hill (R-AK) and Hollingsworth (R-IN) pushed back, with Rep. Hill saying that such a move would hinder reform efforts and Rep. Hollingsworth arguing that this would be a preemptive bailout. Rep. Capuano (D-MA) said that, if Treasury continues to deplete the GSEs' capital buffers, then g-fees should be cut substantially because they will be acting as a tax. Mr. Watt said g-fees are a separate issue and disagreed with Rep. Capuano that he had the authority to take this approach.
- **GSE Capital Post-Conservatorship:** Rep. Strivers (R-OH) asked if the director considered the GSEs systemically important and what their capital levels should be. Mr. Watt said that, outside of conservatorship, the GSEs would be systemically important and that, when credit risk transfers are considered, capital should be around two to three percent. Separately, when asked by Rep. Kustoff (R-TN) what the GSE's capital ratio should be, Mr. Watt indicated that it should be between three and five percent.
- **Conforming Loan Limits:** Rep. Hultgren (R-IL) asked if lowering conforming loan limits would encourage private sector participation and reduce risk to taxpayers. Mr. Watt said that these are set through statute and is therefore Congress' prerogative. Rep. Sherman (D-CA) said that conforming loan limits should not be lowered.
- **Alternative Credit Scoring:** Rep. Himes (D-CT) asked if FHFA would authorize a pilot program allowing the use of alternative data in credit scores. Mr. Watt said this is very difficult due to the need to ensure real competition. He said the agency will be issuing a RFI on the subject.
- **Nonbank SIFI Designations:** Rep. Meeks (D-NY) asked Mr. Watt to discuss his dissent from AIG's de-designation. Mr. Watt said that he opposed the de-designation on both procedural and substantive grounds. He believes that the law requires that seven FSOC members vote to rescind a designation even if a member abstains as SEC Chairman Clayton did. He also believes that the committee did not adequately consider all the factors that make a firm systemically important.